

7535-01-U

## **NATIONAL CREDIT UNION ADMINISTRATION**

### **12 CFR Part 701**

#### **Loan Interest Rates**

**AGENCY:** National Credit Union Administration.

**ACTION:** Final Rule.

#### **SUMMARY:**

The current 18 percent per year federal credit union loan rate is scheduled to revert to 15 percent on September 9, 2000, unless otherwise provided by the NCUA Board (Board). A 15 percent ceiling would restrict certain categories of credit and adversely affect the financial condition of a number of federal credit unions. At the same time prevailing market rates and economic conditions do not justify a rate higher than the current 18 percent ceiling. Accordingly, the Board hereby continues an 18 percent federal credit union loan rate ceiling for the period September 9, 2000, through March 8, 2002. Loans and lines of credit

balances existing prior to May 18, 1987, may continue to bear their contractual rate of interest, not to exceed 21 percent. The Board is prepared to reconsider the 18 percent ceiling at any time should changes in economic conditions warrant.

**DATES:** Effective August 21, 2000.

**FOR FURTHER INFORMATION CONTACT:** Daniel Gordon, Senior Investment Officer, telephone 703-518-6620.

## **SUPPLEMENTARY INFORMATION**

### Background

Public Law 96-221, enacted in 1979, raised the loan interest rate ceiling for federal credit unions from one percent per month (12 percent per year) to 15 percent per year. It also authorized the Board to set a higher limit, after consulting with the Congress, the Department of Treasury and other federal financial agencies, for a period not to exceed 18 months, if the Board determined that: (1) money market interest rates have risen over the preceding six months; and (2) prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in growth, liquidity, capital, and earnings.

On December 3, 1980, the Board determined that the foregoing conditions had been met. Accordingly, the Board raised the loan ceiling for nine months to 21 percent. In the unstable environment of the first-half of the 1980s, the Board lowered the loan rate ceiling from 21 percent to 18 percent, effective May 18, 1987. This action was taken in an environment of falling market interest rates from 1980 to early 1987. The ceiling has remained at 18 percent to the present.

The Board believes that the 18 percent ceiling will permit credit unions to continue to meet their current lending programs, permit flexibility so that credit unions can react to any adverse economic developments, and ensure that any increase in the cost of funds would not affect the safety and soundness of federal credit unions.

The Board would prefer not to set loan interest rate ceilings for federal credit unions. Credit unions are cooperatives and balance loan and share rates consistent with the needs of their members and prevailing market interest rates. The Board supports free lending markets and the ability of federal credit union boards of directors to establish loan rates that reflect current market conditions and the interests of their members. Congress has, however, imposed loan rate ceilings since 1934. In 1979, Congress set the ceiling at 15 percent but authorized the Board to set a ceiling in excess of 15 percent, if conditions warrant. The following analysis justifies a ceiling above 15 percent, but at the same time does not support a ceiling above the current 18 percent. The Board is

prepared to reconsider this action at any time should changes in economic conditions warrant.

### Recent Economic Activity

A number of measures of inflation continue to reflect price pressures on the economy. The Gross Domestic Price Deflator, a broad measure of inflation, rose at a three percent annual rate in the first quarter, the largest increase since a similar rise in the first quarter of 1995. The Consumer Price Index rose 3.1 percent from May 1999 through May 2000, compared to 2.7 percent for all of last year. The personal consumption expenditure price index, a separate measure tied to Gross Domestic Product, rose at a 3.1 percent annual pace in the first quarter, above the 2.5 percent rate of increase in the last three months of 1999.

The economy is continuing to expand at a rapid rate increasing inflationary concerns. Gross Domestic Product grew at a very strong 5.5 percent annual rate in the first three months of this year, after a 7.3 percent increase in the fourth quarter of 1999 and a 5.7 percent rise in the third quarter of 1999. Consumer spending, which has been the engine of this long-term expansion, soared at 7.7 percent annual rate in the first quarter of 2000, the largest increase in 17 years. The University of Michigan's measure of consumer confidence remains close to the level reached last year, suggesting high consumer spending will be sustained.

## Money Market Interest Rates

Inflationary concerns and expectations about the future level of economic activity have led to a substantial tightening by the Federal Reserve. Table 1 indicates that the Federal Reserve has raised its target fed funds rate six times between June 1999, when the target rate was increased from 4.75 percent to 5.00 percent, and June 2000, when the target rate was increased 50 basis points from 6.00 to 6.50 percent. In choosing to raise rates in May 2000, the Federal Reserve concluded that gains in worker productivity “could no longer” offset the impact of higher costs.

The 6.50 percent target rate is the highest such target in nine years. Although the Federal Reserve chose not to raise the target rate again last month, its accompanying statement suggested inflation is still of substantial concern. In its official statement, the Federal Reserve indicated that “the risks continue to be weighted mainly toward conditions that may generate heightened inflation pressures in the foreseeable future....[s]igns that growth in demand is moving to a sustainable pace are still tentative and preliminary.”

Individual Federal Reserve officials have elaborated on the Federal Reserve’s official statement. For example, the President of the Chicago Federal Reserve, Moskow, said, “we still are in a period where aggregate demand is growing at a

pace that is exceeding potential supply.... I haven't seen any significant adjustment up to this point." Richmond Federal Reserve President Broadus said that core prices, excluding food and energy prices, "have shown signs of acceleration."

The implied rate on futures contracts for September is 6.70 percent, suggesting financial markets anticipate another increase in the fed funds target rate at the August Federal Reserve Open Market Committee meeting.

Table 1  
Recent Changes in Federal Reserve  
Target Fed Funds Rate

Date	Fed Funds Target Rate (Percent)
May 2000	6.50
March 2000	6.00
February 2000	5.75
November 1999	5.50
August 1999	5.25
June 1999	5.00

Table 2 shows that that in the last six months there has been an increase in interest rates in the three-month to two-year maturities, of greatest relevance to a credit union's cost of funds.

Table 2  
Yields on Government Securities

Maturity	December 31, 1999	June 30, 2000	Change
3 month	5.31%	5.82%	.51%
6 month	5.73	6.19	.47
1 year	5.96	6.05	.09
2 year	6.24	6.35	.11
5 year	6.34	6.19	-.16
10 year	6.44	6.03	-.41
30 year	6.48	5.88	-.60

### Financial Implications For Credit Unions

For at least 731 credit unions, representing 11<sup>1</sup> percent of the reporting federal credit unions, the most common rate on unsecured loans was above 15 percent. While the bulk of credit union lending is below 15 percent, small credit unions

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<sup>1</sup> Of the 6489 federal credit unions, 5,002 had zero balances in the 15 percent and above unsecured loan rate category or did not report a balance for the December 1999 reporting period.

and credit unions that have instituted risk-based lending programs require interest rates above 15 percent to maintain liquidity, capital, earnings, and growth. Loans to members who have not yet established a credit history or have weak credit histories have more credit risk. Credit unions must charge rates to cover the potential of higher than usual losses for such loans. There are undoubtedly more than 731 federal credit unions charging over 15 percent for unsecured loans to such members. Many credit unions have “Credit Builder” or “Credit Rebuilder” loans, but only report the “most common rate” on the Call report for unsecured loans. Lowering the interest rate ceiling for federal credit unions would discourage these credit unions from making these loans. Credit seekers’ options would be reduced and most of the affected members would have no alternative but to turn to other lenders who will charge much higher rates.

Small credit unions would be particularly affected by lower loan rate ceilings since they tend to have a higher level of unsecured loans, typically with lower loan balances. Thus small credit unions making small loans to members with poor or no credit histories are struggling with far higher costs than the typical credit union. Both young people and lower-income households have limited access to credit and, absent a credit union, often pay rates of 24 to 30 percent to other lenders. Rates between 15 and 18 percent are attractive to such members.



Table 3 shows the number of credit unions in each asset group where the most common rate is more than 15 percent for unsecured loans.

Table 3  
Active Federal Credit Unions with Most Common  
Unsecured Loan Rates Greater than 15 Percent  
December 1999

Peer Group By Asset Size	Total All FCUs	Number of FCUs with Loan Rates equal or greater than 15 percent
\$0-2 million	1,697	178
\$2-10 million	2,212	258
\$10-50 million	1,725	202
\$50 million+	855	93
Total	6,489	731

Among the 731 credit unions where the most common rate is more than 15 percent for unsecured loans, 121 have 20 percent or more of their assets (Table 4) in this category. For these credit unions, lowering the rates would damage their liquidity, capital, earnings, and growth.

Table 4  
Active Federal Credit Unions with Most Common Unsecured  
Loan Rates Greater Than 15 Percent and More Than  
20 Percent of Assets in Unsecured Loans  
(December 1999)

Peer Group By Asset Size	Average Percentage of Loan Rates Greater than 15 percent to Total Assets	Number of FCUs with Loan Rates Equal or Greater than 15 percent
\$0-2 million	40	81
\$2-10 million	28	32
\$10-50 million	36	5
\$50 million+	21	3
Total	125	121

In conclusion, the Board has continued the federal credit union loan interest rate ceiling of 18 percent per year for the period September 9, 2000 to March 8, 2002. Loans and line of credit balances existing on May 16, 1987, may continue to bear interest at their contractual rate, not to exceed 21 percent. Finally, the Board is prepared to reconsider the 18 percent ceiling at any time during the extension period should changes in economic conditions warrant.

## **REGULATORY PROCEDURES**

### **Administrative Procedure Act**

The Board has determined that notification and public comment on this rule are impractical and not in the public interest. 5 U.S.C. 553(b)(3)(B). Due to the need for a planning period prior to the September 9, 2000, expiration date of the current rule, and the threat to the safety and soundness of individual credit unions with insufficient flexibility to determine loan rates, final action on the loan rate ceiling is necessary.

### **Regulatory Flexibility Act**

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (those under one million dollars in assets). This final rule provides added flexibility to all federal credit unions regarding the permissible interest rate that may be used in connection with lending. The NCUA Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small credit unions.

## **Paperwork Reduction Act**

NCUA has determined that this rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

## **Executive Order 13132**

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interest. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule applies only to federal credit unions and, thus, will not have substantial direct effects on the states, on the relationship between the national government and the states, nor materially affect state interests. The NCUA has determined that the rule does not constitute a policy that has any federalism implication for purposes of the executive order.

## **Small Business Regulatory Enforcement Fairness Act**

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined

by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. NCUA has recommended to the Office of Management and Budget that it determine that this is not a major rule and is awaiting its determination.

**The Treasury and General Government Appropriations Act, 1999 –  
Assessment of Federal Regulations and Policies on Families**

NCUA has determined that this rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Loan interest rates.

By the National Credit Union Administration Board on July 13, 2000

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Becky Baker

Secretary to the Board

Accordingly, NCUA amends 12 CFR chapter VII as follows:

**PART 701- ORGANIZATION AND OPERATION OF FEDERAL CREDIT  
UNIONS (AMENDED)**

1. The authority citation for Part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 1766, 1767, 1782, 1784, 1787, and 1789. Section 701.6 is also authorized by 15 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq., 42 U.S.C. 1981 and 3601-3610. Section 701.35 is also authorized by 42 U.S.C. 4311-4312.

2. Section 701.21(c)(7)(ii)(C) is revised to read as follows:

701.21 Loans to members and lines of credit to members.

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(c) \*\*\*

(7) \*\*\*

(ii) \*\*\*

(C) Expiration. After March 8, 2002, or as otherwise ordered by the NCUA Board, the maximum rate on federal credit union extensions of credit to members shall revert to 15 percent per year. Higher rates may, however, be charged, in accordance with paragraph (c)(7)(ii)(A) and (B) of this section, on loans and line of credit balance existing on or before May 16, 1987.

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